No. 12,506

IN THE

United States Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, RECEIVER,
Plaintiffs and Appellants,

and

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants and Appellees.

Reply Brief of Appellants The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver

---

HERMAN PHLEGER,
MAURICE E. HARRISON,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

FRANK C. NICODEMUS, JR.,
44 Wall Street, New York 5, N. Y.

A. PERRY OSBORN,
20 Exchange Place, New York 5, N. Y.

NORRIS DARRELL,
48 Wall Street, New York 5, N. Y.

MAHLON DICKERSON,
120 Broadway, New York 5, N. Y.

LEROY R. GOODRICH,
Bank of America Building,
Oakland 12, Calif.

Attorneys for Plaintiffs and Appellants

PARKER PRINTING COMPANY, 180 FIRST STREET, SAN FRANCISCO

SUBJECT INDEX

INDEX OF AUTHORITIES

Table of Cases — Pages

STATUTES AND REGULATIONS

TEXTS

No. 12,506

IN THE

United States Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,
Plaintiffs and Appellants,

and

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants and Appellees.

Reply Brief of Appellants The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver

---

An examination of defendant's brief shows the following prop-
sitions proved or admitted:

Appellee The Western Pacific Railroad Company will be referred to as
efendant, and appellant The Western Pacific Railroad Corporation as
laintiff. The symbol "O.B." will be used to refer to that appellant's open-
g brief; "D.Br." refers to appellee's brief. References to the record and
hibits will be made in the manner described in the footnote on O.B. 2.

1. The defendant paid its $17,000,000 tax liability by the us of plaintiff's loss; otherwise the $17,000,000 would have bee paid by defendant into the United States Treasury.*

2. The plan of using plaintiff's rights was conceived and e ecuted by defendant without any consideration whatever of plai tiff, at a time when plaintiff's officers were employees of defen ant and acting at its direction.

3. At the time, plaintiff had no economic interest in defen ant and owed it no duty. On the contrary, defendant occupie a fiduciary relationship toward plaintiff.

On plain principles of law it is submitted that plaintiff is ther fore entitled to judgment.

Defendant's brief is mainly devoted to three arguments:

1. Defendant contends that plaintiff cannot recover because wh was done was in accord with general business practice ar the previous conduct of these parties.

The short answer to this is that it is not so. When the retur were filed plaintiff was a complete economic stranger to defen ant and had no pecuniary interest in it. What was done at a earlier time when plaintiff owned all defendant's stock and ben fited from any tax or other advantage accruing to defendant completely irrelevant here. As the court below held, in excludin defendant's proffered evidence of general business practice, the is not only no general practice in the filing of consolidated r turns by companies where one has no economic interest in th other but this case is *sui generis*.

2. Defendant contends that a judgment for plaintiff would ci cumvent the reorganization plan and give plaintiff a share c

*Defendant's brief, admitting savings from use of plaintiff's right asserts that they are some unspecified amount less than $17,000,000 becau it would have been possible for defendant "to file separate returns and tak advantage of deductions unavailable under consolidated returns" (D.B 26, 65, 66).

The same contention was tried, briefed and argued below, and the tri court found against defendant. It found specifically (267) that the ta benefit which defendant obtained by use of plaintiff's loss was $17,201,73

defendant's earnings, after the Supreme Court had held that its interest was valueless.

The answer to this is that the reorganization plan contemplated hat defendant would pay its taxes in full, and it would have done o if it had not appropriated plaintiff's loss and used it to pay its axes. Plaintiff does not seek to share in defendant's earnings, or o share in its equity. It asks that defendant account for the benefit received through the use of plaintiff's property and rights—the lischarge of its $17,000,000 tax liability (see O. B. 93).

. Its attempt to defeat plaintiff's claim on the merits failing, defendant argues that even though it may owe plaintiff $17,-000,000, it need not pay because the claim was not presented in the bankruptcy court and is barred by its final decree.

The answer to this is that pursuant to the Reorganization Plan nd the court's decree defendant assumed and agreed to discharge ll liabilities of the trustees, which would include this liability if arose during bankruptcy; but in fact the liability arose and the bligation to account became fixed long afterward. The final ecree was not intended to, did not and could not bar plaintiff's laim.

These are defendant's chief points. We cannot refrain from oting that in defendant's brief there is an entire absence of a ecognition that throughout this transaction defendant was a duciary for plaintiff and owed it the duty of acting in the highest ood faith and with a scrupulous regard for the rights of its stock-olders who had lost their $75,000,000 investment. Defendant's rief shows a like disregard, or perhaps a studied avoidance, of e fact that during this time plaintiff and defendant were entire onomic strangers, without financial interest one in the other. hese attitudes explain perhaps, though they do not excuse, the efendant's callous disregard of plaintiff's rights. Defendant may

have believed, if it gave any thought to plaintiff at all, which we doubt, that a corporation in ruin, with its principal officer in the office of the defendant's attorney and in the defendant's pay, had no rights.

It would indeed be a perversion of equity and the Revenue Laws if the defendant who owed $17,000,000 in taxes, and paid those taxes by using plaintiff's property and rights, should retain the unjust enrichment thus resulting. There has been much talk of "tax savings" here. In reality the defendant simply paid its taxes with the plaintiff's property. The government permitted taxes to be paid in this way, because the policy of the law intended the benefit thereof to ameliorate the loss of the affiliate, whose loss paid the tax. Defendant took something having a use value of $17,000,000 away from the plaintiff and paid its own taxes with it. Justice is not impotent to grant relief, simply because the factual situation is unique and the amount involved large.

Defendant argues that "merchandising tax advantages" is against the policy of the law (D. Br. 64). If the use of plaintiff's rights to give defendant a tax advantage was rightful as respects the government—and defendant and plaintiff agree that it was—it is pharasaical to say that defendant is precluded from accounting for the advantage. And, if its use as respects the government were wrongful, it is a strange argument to contend that there is a public policy which requires a wrongdoer to keep its pockets lined (cf. O. B. 82-87). As we have shown (O. B. 39-50), only an accounting to plaintiff can remove the case from the condemnation of "merchandising tax advantages" and of utilizing consolidated returns for merely tax reducing purposes.

The chief characteristic of defendant's brief is that a number of legal fallacies and erroneous assumptions run throughout all its arguments. If these are extracted, the arguments crumble.

This Reply Brief is divided into: (1) An analysis of defendant's principal assertions on the merits, and (2) an answer to the technical defense that even if plaintiff "had a valid claim," it is barred by the Reorganization decree (D. Br. 68-83).

DISCUSSION

I.

DEFENDANT'S ARGUMENTS ON THE MERITS ARE PERMEATED BY CERTAIN FALLACIES AND ERRONEOUS ASSUMPTIONS

A. The Fallacious Persistence in Refusing to Recognize the Unique Fact of This Case—the Severance of the Economic Unity—and in Referring to Alleged "Past Practice" and Alleged "General Practice."

Defendant asserts that it was the uniform "practice" of plainiff and defendant to file consolidated returns and for the affilite with a loss to receive nothing for it. Almost every contenion that it makes comes back to this as its keystone.*

Yet at the outset it insists that the "pre-reorganization The Western Pacific Railroad Company" and the "reorganized The Western Pacific Railroad Company" are two different entities (D. 3r. 2). Technically, the company is the same corporation, before nd after reorganization, for the assets taken over by the trustees n 1935 were revested in the same corporate entity in December 944.

But the capital stock was owned by different people after the eorganization than before. While this difference did not change he corporate entity, it cuts the ground from under defendant's rguments about past practice.

Prior to the reorganization plaintiff was defendant's owner. 'hereafter defendant was a total stranger to the plaintiff, with ew owners. And if defendant is not now compelled to account, hese new owners will be the people who will be enriched by use f plaintiff's rights.

The Supreme Court's decision of March 15, 1943, and the rder of October 11, 1943, confirming the Plan of Reorganization ompletely changed the relationship of the parties to each other. Jntil these occurrences the plaintiff and the defendant were an conomic unity—a single family. So long as that unity continued,

*E.g., D.Br. 7, 18, 22, 30, 35, 38, 42, 52, 59, 65, 66, 67.

a decision to file consolidated returns was that of the parent; the profits, gains or benefits of the subsidiary, or its losses or detriments, flowed to the plaintiff's stockholders sooner or later, since it was the owner of the economic unity. It was a matter of indifference where the benefits or detriments happened to fall in the first instance or whether a subsidiary accounted to the parent for any tax savings resulting from the use of the parent's tax credits or, instead, those savings inured to the parent through its ownership.

The Supreme Court's decision and the order of confirmation severed the economic unity. After March 15, 1943, the defendant was no longer in any real sense the same party which had filed consolidated returns with the plaintiff in the years prior to 1942. Consequently, "past practice" is irrelevant. The trial court so held. As it said (1377):

> "I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, and of course there is no dispute about the fact that the parent company filed the affiliated returns whenever it decided it was proper to do so. What we have in this case is not concerned with that."

"Past practice" is irrelevant, not only because the relationship between the parties to whom that practice applied had vitally changed, but because there was not in fact any practice whatever in prior years that has any relation to the facts of this case. The situation here was unique. The loss used to produce the tax savings was the loss of the parent's stock in the subsidiary. Yet (1) it was an amendment to the tax law in October, 1942, that made the utilization of this kind of loss possible at all (see O. B. 43-44); and (2) use of that loss to eliminate the former subsidiary's tax was "paradoxical" (see O. B. 17). Although the loss was the result of severing the economic unity, the subsidiary was enabled to use the loss by reason of the tax concept of consolidated returns which has its rationale in the existence of that unity.

Furthermore, the only respect in which past practice could con- ceivably be relevant would be in the construction of a contract entered into by parties with each other. But in this case there was no such contract. Defendant simply took over and carried through the tax matters without agreement. Defendant asserts (D. Br. 66) that "one who participates in an established course of conduct over a long period may not, after the event, attach new conse- quences to the customary activity," and it cites cases where the evidence showed a contract defining the rights of the parties. Here what was done prior to the critical event of the severance of the economic unity cannot evidence a contractual consent to what was thereafter done in circumstances utterly different, involving a kind of loss the like of which had never before been known and which never before could have been the subject of tax deductions.*

PRACTICE OF OTHER COMPANIES.

Defendant also makes numerous statements about what it calls "the general practice of the business community" (e. g., D. Br. 2). There is no evidence of any such practice. As defendant ad- mits (D. Br. 53), the elaborate evidence offered by it was ex- cluded by the court as irrelevant (1377-1383, 1394).

---

*Actually, the evidence as to past practice is quite empty. In the 11 years, 1930-1941, inclusive, there was not a single year in which the *parent's* tax credits were utilized by the *subsidiary* defendant. In that period no taxes at all were paid by the affiliated group (1263). In the years 1936-1941, inclu- sive, neither plaintiff nor defendant had taxable income, both had losses, and on a separate return basis neither would have had to pay a tax (2040 D 46; 2041 D 47). What happened in those years could therefore have no bearing on the only practice that could conceivably be relevant—whether the defendant, a subsidiary, had in the past accounted to the parent for tax savings resulting from use of the parent's credit.

In the years 1930-1935, while the parent had some net income, the de- fendant had losses, so that the subsidiary was not saved from taxes by the parent's tax credits (2040, 2041).

The years prior to 1930 are too remote. Prior to 1922 consolidated re- turns were mandatory under the tax laws (see O.B. 39), so a wholly dif- ferent question would have been involved. In the next 7 years, 1923-1929, in only two instances (1925 and 1928) did the parent's loss result in tax savings to defendant subsidiary and then for only slightly more than $20,000 (2041), of which plaintiff received the benefit as owner of the enterprise.

An appellee may not support a judgment by evidence exclude below.* The proffered evidence ignored the vital and unique fac in this case, the severance of the economic unity, which distin guishes this case from all others. As the trial court said in exclud ing the evidence (1379):

> "The question would never arise under the general busi ness practice, because I do not think you would ever hav any litigation. Absent the kind of situation that you hav here between companies that were free agents to agree witl one another to file this type of return. Here you have a situa tion where a third party, a new party, is getting the benef of this tax situation. * * * the problem that is presented b it is entirely different from what might happen in the ord nary business relationship of parent and subsidiary com panies, where you have not the interposition of reorganiza tion proceedings and all that they entail."

This case involves no general question of how losses should b shared between affiliated corporations when consolidated return are filed. It involves the loss to the parent of its ownership in it subsidiary, thus bringing about a severance of the economic unit then and there so that the parent can no longer achieve the bene fits of the tax savings through its continued ownership. (See ques tion, O. B. 29.)

Defendant cites no instance where such a loss was ever availe of by the former subsidiary to avoid what would otherwise be it tax obligations. This fact disposes of the argument that a judg ment for plaintiffs will create uncertainties in the law (D. Br. 64)

ANSWER TO DEFENDANT'S DISCUSSION OF THE SEVERANCE OF THE ECONOMIC UNITY.

Defendant's answer to the unique fact of the case is no mor than a denial that there was a severance of the economic unity an a mere assertion that the fact is without significance (D. Br 60-64).

**Shepherd v. Turner,* 129 Cal. 530, 62 Pac. 106; *People v. Canadia Fur Trapper's Corp.,* 248 N.Y. 159, 161 N.E. 455, 458.

Defendant contends that the confirmation of the Plan "severed nothing" (D. Br. 60) because the "affiliation" continued to April 1944. But that continued "affiliation" was technical only. Had not the worthless stock been surrendered the assets would have been vested in a new corporation (see O. B. 25, 26).

Defendant argues that "economic unity" in matters of consolidated returns is a false factor, because a subsidiary may have bonds or non-voting preferred stock outstanding. This flies in the face of the principle upon which consolidated returns are based, namely, that a single business enterprise, though conducted by separate corporations, shall be taxed as a unit. For consolidated returns to be available, the parent must own not only 95% of the voting stock but 95% of all non-voting stock other than preferred stock limited as to dividends. (Internal Revenue Code, Sec. 141(d).) In short, the parent must own what for practical purposes is the entire equity.*

Holdings by others of interests which do not share fully in the equity do not affect the economic unity. If, as defendant argues, tax savings go to pay bondholders or preferred stockholders, then payment of these overriding obligations *pro tanto* lifts the load depressing the equity and correspondingly increases its value to the benefit of the parent. The economic unity continuing, precise mathematical admeasurement of the benefit to the parent is of

---

*At page 42 of our Opening Brief we quoted briefly from a Senate Report. Quoting more extensively, the passage reads:

> "Much of the misapprehension about consolidated returns will be removed when it is realized that it is only when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidateed returns only where one corporation owning at least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts." (S.R. 960, 70th Cong., 1st Sess., p. 8)

Defendant itself quotes this passage from a Treasury Regulation:

> "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise." (D.Br., Appendix, p. 20)

no consequence. On the other hand, if the overriding load is so great that in fact there is no equity, e. g., if the subsidiary is insolvent, the economic unity has in effect been severed. Such, for example, was the situation presented in *Bankers Trust Company v. Florida East Coast Car Ferry Co.*, 92 F.2d 450 (discussed O. B 48).*

DEFENDANT'S ASSERTIONS ABOUT "ALL THE PRECEDENTS."

Defendant's fallacy about alleged "general practice" vitiates its assertions about "all the precedents" as "guides for the proper settlement of intra-group liabilities" (e. g., D. Br. 22, 50, 52-58)

In this category fall its references to an investigation by the Federal Trade Commission in the late 1920's of utility holding companies, the enactment 8 years later of the Public Utility Holding Company Act of 1935, and Rule U-45 issued thereunder by the Securities and Exchange Commission.†

There is a significant lesson to be drawn from the action of the S. E. C. under its Rule U-45, but it is the reverse of what defendant contends. When an affiliate's tax savings resulting from the use of another affiliate's loss could not or might not reach the

---

*Defendant glides from discussion of a case where a parent's losses are used to benefit a subsidiary to the quite different case where the latter's losses are used to benefit a parent. But, the economic unity continuing the subsidiary has no interests apart from the parent. As said in *Estate of John B. Lewis,* 10 T.C. 1080 (1948):

> "To say that a corporation, as such, can have motives and purposes apart from its stockholders, the collective group of individuals who own it, is to indulge in metaphysical reasoning * * * and to say that what is advantageous to the stockholders * * * is of no advantage to the corporation is utterly unrealistic."

If facts should ever arise whereby, despite economic unity, the use of a subsidiary's losses to benefit the parent should encroach on the rights of the subsidiary's bondholders or minority preferred stockholders, equity is competent to protect them. Minority interests have frequently been protected in the past, in a variety of situations.

†The Public Utility Holding Company Act of 1935 is not relevant. It pertains to gas and electric companies and contains nothing about consolidated returns but conferred power on the S.E.C. to regulate intercompany transactions. Under it the S.E.C. issued Rule U-45, which prohibits certain intercorporate donations unless made pursuant to prior notice to the Commission, but exempts certain tax transactions.

party suffering the loss through ordinary channels, as by way of dividends or increase of its equity—the S. E. C. has considered it equitable that the benefit of the tax savings be passed directly to the party who suffered the loss.

The S. E. C. cases discussed in our Opening Brief (at pp. 44-47) so show. Defendant seeks to distinguish one of the two cases, *In the Matter of Consolidated Gas & Electric Company,* 13 S. E. C. 549, by asserting that the affiliate (Islands) whose loss was used would thereby be subjected to a future tax, and that the group members merely proposed an arrangement to put it in the same position as if it had filed a separate return (D. Br. 54).

But this is not the fact, for the S. E. C found that the amount of the future tax would "be considerably less than the tax savings to be presently effected" (13 S. E. C. at 653). The proposal was that the *whole* of the tax saving should be paid to Islands, and it was this proposal that the S. E. C. approved (13 S. E. C. at 652).

Of the other S. E. C. decision *(In the Matter of Consolidated Electric & Gas Company,* 15 S. E. C. 161) defendant says (D. Br. 55):

> "Since the parent who received the payment was entitled to the money in any event, the Commission saw this case only as an accounting problem and agreed to the proposed arrangement for that reason."

This is nothing less than a concession that tax savings resulting from use of a parent's loss belong to the parent.

The two S. E. C. cases involved the same group, and as shown in one of them, "the announced program of Consolidated is one for the liquidation of the Consolidated system" (13 S. E. C., p. 553, footnote). Since the economic unity was to be severed, it was equitable that the tax savings resulting from use of the parent's loss go to it at once. It was this equity that the S. E. C. recognized.

Defendant quotes from an S. E. C. release discussing accounting practice (D. Br. 52), wherein it is said that no part of tax savings is "ordinarily" paid to the loss company. The present

case is not the "ordinary" one. More of the release is quoted in an appendix to defendant's brief (App. pp. 7-14). The text of the release shows that the S. E. C. was not directing its remarks to a case, such as this, where the loss is that of the parent itself. Ordinarily losses are those of subsidiaries, since the parent, not being an operating company, can sustain losses only in the unusual case of worthlessness of its security holdings. The S. E. C. was referring to the normal situation of a continuing economic unity, and the alternatives noted were (a) allocation of all the savings to the affiliate having the loss or (b) sharing it. There is no mention whatever of the third course that defendant espouses—that of grim retention of *all* the savings by the affiliate whose taxes are reduced by use of the parent's loss (D. Br. App. 13).

The Federal Trade Commission investigation mentioned by defendant related to gas and electric holding companies and practices prevailing within groups in which there was a continuing economic entity. What concerned the F. T. C. was the abuse of accounting practices as the result of which amounts paid as or in lieu of federal taxes were added to operating expenses to increase rates.*

Defendant asserts that Treasury rulings "assume and provide" for a pro rata allocation of the tax "without tax saving payments" (D. Br. 56). Nothing could be farther from the truth, and the provisions of the various revenue acts which it cites are the very ones we referred to as recognizing the propriety of agreements between affiliates respecting apportionment (O. B. 53-54). For the protection of the Treasury the regulations list certain circumstances wherein intra-group agreements are not recognized for certain purposes. Defendant refers to these provisions, but they

---

*The Commission felt that the "amounts paid as federal income tax should be deducted from the net income on which the tax was calculated" and not treated as an expense of operation (D.Br. App. 4, next to last paragraph) and it condemned certain accounting procedures because they resulted in "an inaccurate recording of the true cost of operations of the electric and gas operating companies" (D.Br. App. 3, end of second paragraph). All this is irrelevant to the present case.

are foreign to the case.* The very specification of these instances and purposes shows that for all other purposes the relations of the parties are left to be adjusted by agreement or, in the absence of an agreement, by appropriate principles of equity.†

Nowhere does defendant show any practice where the loss is that of the parent's stock interest in the subsidiary, as is the case here. The reason is obvious, for in the first place the use of such a loss was first authorized in October, 1942, and in the second place this case is unique, "paradoxical" to use the expression of defendant's tax counsel.

---

*For certain purposes it is necessary to determine earnings and profits available for dividends, and to this end taxes chargeable to each affiliate must be determined. For this calculation the Treasury requires the consolidated tax to be apportioned in a certain manner.

Defendant even refers to the regulation that, if a parent has reduced its own tax by use of a subsidiary's loss, the base at which the parent holds the subsidiary's stock for determining capital gains or losses must be reduced accordingly. The provision merely recognizes the obvious fact that the parent has reduced its investment in the subsidiary by taking advantage of the loss. There is no provision for reduction of the base where a subsidiary takes advantage of a parent's loss, which is the present case. The regulation shows the Treasury's view of the rationale of consolidated returns to be exactly what we contend, namely, that the parent is the ultimate economic owner of the enterprise and the ultimate beneficiary of tax savings. The defendant argues that if the parent has to make a payment to the subsidiary for its loss, the parent would be paying twice. This ignores the fact that there is no reason why a parent should pay a subsidiary for a loss so long as the economic unity continues, in the absence of unusual factors. It would be as absurd as for the head office of a single corporation to pay one of its departments for a loss. See footnote on p. 10, supra.

†In its search for support, the defendant finally comes to the Interstate Commerce Commission. It admits that the I.C.C. has never passed on the handling of consolidated returns, but asserts that the Commission has "rejected tax savings claims" (D.Br. 58). The two cases which it cites are not remotely in point. Neither involved the use of one person's losses or tax credits to reduce taxes of another. For example, *St. Louis San Francisco Railway Co. Reorganization*, 257 I.C.C. 399, 410, was a case where a debtor contended that it was entitled to some credit because by failing to pay its creditor all that it owed, the creditor had less income and therefore less taxes.

B. The Fallacious Notion That Tax Savings Cannot Be the Subject of Equitable Cognizance or of an Accounting.

Defendant's essential argument is that the nature of plaintiff's claim cannot be subsumed under the traditional categories of common law liability. Thus it says that plaintiff "suffered no tort; no contract was breached; no statutory right was infringed" (D. Br. 24). It even makes the odd argument that plaintiff should be denied recovery because it has no "title" to the funds from which a judgment would be paid.

But the doctrines of quasi-contract and unjust enrichment have never been restricted to cases of express contract, of torts coming within the scope of common law writs, or of title.

Defendant finally confronts the essential fact of the case—that it has been enriched by use of plaintiff's tax rights—by asserting that plaintiff's claim cannot be the subject of judicial cognizance because a loss is a "negative factor" and a saving in taxes is "a negative concept."

The *Shreveport Bank* cases (discussed at length, O. B. 36-38) show that tax savings or tax advantages are not negative concepts and are the subject of equitable accountability. Defendant entirely ignores this aspect of those cases and merely says that they involve a fiduciary relationship.* (D. Br. 43, 44).

Defendant admits that "if separate returns had been filed" or if plaintiff's stock loss had not been used, there would have been "additional taxes" (D. Br. 25, 26). But it argues that a saving of taxes is not an enrichment because taxpayers have a legal right to take deductions allowed by law, and it quotes a portion of the trial court's opinion that a tax saving is a negative concept because "no benefit could inure from participating in non-payment of an

---

*Defendant insinuates that the Shreveport decision was "over dissent." But the point of the dissent on the second appeal was that still other property belonged to the old bank and that tax savings arising from that property should also have gone to plaintiff. The whole court was in accord that the tax savings were the subject of equitable accountability.

Defendant (Br. 44) cites two cases, *Hopkins v. Detrick,* 97 A.C.A. 55, and *Cooper v. Central Alloy Steel Corporation,* 183 N.E. 439, 43 Ohio App. 455. They are quite irrelevant.

obligation, unless there rested upon the participant an obligation to pay" (D. Br. 13). But here defendant *was* under the obligation to pay $17,000,000 of taxes and it discharged that obligation by use of plaintiff's rights. The only reason why the law did not require the "additional tax" was that the defendant appropriated and used plaintiff's stock loss and tax rights. Defendant would not have been able to utilize those rights unless it could introduce itself into consolidated returns with plaintiff, a procedure which plaintiff could have denied and which was effected by defendant's directions to plaintiff's president who was in its pay.

Similarly, the assertion that a loss is a "negative factor" is fallacious (see O. B. 74-75). *This* loss was *not* a negative factor, because the tax laws made it of positive value. While this is a case of general equity jurisprudence and not a tax case, the tax laws enter into it as part of the factual background. The tax laws provided that *this* loss could be used in certain circumstances to pay taxes. Therefore this loss had an asset value. It acquired value in precisely the same way as anything has value, to wit, because it had a valuable use.*

And it was actually used in this case to save $17,000,000.

It is fatuous, we submit, for defendant to deny that value. Rather, it is incumbent on it to justify its arrogation of that value to itself.†

---

*The argument (e.g., D.Br. 48, 64) that the revenue acts create no private rights misses the point entirely. If defendant had seized cash of plaintiff to pay its taxes, it could not escape liability with this reasoning.

†Elsewhere (D.Br. 45) defendant seeks to distinguish *In re Missouri Pacific Railroad Company*, No. 6935, U.S.D.C., E.D. Mo. (discussed O.B. 54) on the ground that the affiliate whose loss was there used would be subjected to increased taxes by joining in the consolidated return, while here the plaintiff had "no actual damage." This argument concedes that a loss is not a mere negative quantity, and defendant's argument shrinks to the claim that a plaintiff's recovery for seizure of its rights is its detriment and not the other's gain. Our Opening Brief showed how fallacious this contention is (O.B. 66, et seq.), and we discuss the subject further at pages 17-19 below.

Defendant also says of the *Missouri Pacific* case that the others in the group agreed to pay to their affiliate only the amount of its damage, not the amount of their gain. The fact is irrelevant because there the parties

C. The Refusal to Recognize That Defendant Assumed a Fiduciary Relationship to the Plaintiff and Unilaterally Appropriated Plaintiff's Rights, and That the Benefits Were Not Conferred by Plaintiff on Defendant Either Officiously or as a Gratuity or by Any Voluntary Act but Were Taken.

Defendant next contends that retention of the benefits would not be unjust because, so it argues, the transfer of plaintiff's tax rights to it cannot be set aside for lack of "some recognized basis —fraud, mistake, duress, undue influence, illegality—for revoking the transfer" (Br. 27-29).*

Thereby defendant's next pervasive fallacy is disclosed. Fraud, mistake, and the like are concepts applicable to a voluntary or affirmative act of transfer. Plaintiff did not knowingly transfer anything to defendant. The latter simply took a thing of value belonging to the plaintiff for its own enrichment. The analogies are trespass and conversion. If a tangible chattel had been involved, it would be a case of tortious conversion, since defendant's conduct was a denial of any interest in the plaintiff.

The fallacy appears sharply at pages 27-29 of the brief. Asserting that "The instances in which a plaintiff who confers a benefit on a defendant fails to obtain a judgment for that benefit are legion," it cites (in a footnote) numerous cases. But these are cases where the plaintiff voluntarily chose to confer benefit, or did so as a gratuity, or where the parties were exchanging benefits each understood to be consideration for the other, or where the plaintiff acted for his own benefit and not for the defendant.

Again, it says that "in every windfall situation," wherever one party acquires a windfall, no one else can recover from him (D. Br. 27-29). Of course, where A receives an advantage which is

---

agreed as to the allocation of tax savings. The case demonstrates the right to agree, and thus refutes another argument of the defendant that tax savings cannot be the subject of agreement. Where parties freely make an agreement, they may agree on whatever division they choose. Here defendant avoided an agreement by unilateral appropriation of plaintiff's rights.

*It also asserts that nothing "was taken from" plaintiff, but this is the fallacy just discussed.

unrelated to B, the latter has no right to share in it. There was no "windfall" here, for what defendant gained, it gained not as the result of a fortuitous event, but as the direct result of its appropriation of plaintiff's rights.*

The failure to distinguish between a case where a plaintiff voluntarily confers benefits and one where the defendant simply takes them is revealed by the argument that a recovery for unjust enrichment may not exceed plaintiff's loss (D. Br. 29, 30). Defendant invokes the analogy of the discharge of a debt by a surety, who has become such of his own volition, or other purely voluntary discharge by one of another's debt.†

The Restatement of Restitution affirms (Section 153, p. 607) that where A by conduct improper toward B has discharged his

---

*The cases cited on this point by defendant (D.Br. 28, 29) are largely misdescribed by it. Their actual facts show how far afield defendant strays. In *Straube v. Bowling Green Gas Co.*, 227 S.W.2d 666 (Mo.), plaintiff had paid defendant for gas at the rates fixed by a Public Service Commission and sued for a refund merely because defendant acquired the gas from its own supplier at a legal reduction in the latter's rates. In *Houck v. Hubbard Milling Co.*, 167 N.W. 1039 (Minn.), plaintiff bought wheat from defendant at contract prices and later sued for a refund because defendant had obtained deductions in its own freight rates. The case turned on the construction of the purchase contract. As the court construed that contract, the price at which plaintiff bought wheat was unconnected with defendant's freight rates. *Greek Catholic Congregation v. Plummer*, 32 A.2d 299 (Pa.), is a case where one party quitclaims to another whatever interest he might have in a parcel of land and a third party, the owner, sues for the consideration. In *Russo v. Hosmer*, 44 N.E.2d 641 (Mass.), a subcontractor was denied recovery on his express contract with the main contractor because he had breached the contract in a material respect. He then sought to recover the payments received by the main contractor from the owner. In *Vanderbilt University v. Williams*, 280 S.W. 689 (Tenn.), neither plaintiff nor defendant had a right to receive rent from a third party, but the third party paid rent to the defendant and plaintiff sought a share.

†If the debt is discharged by money payment of less than the face amount, the person discharging it recovers what he paid, and if the debt is discharged with property instead of money he is entitled to its value. These illustrations cast no light on how to determine the value of what is paid. If what is paid is cash, its value is simple to ascertain. If it is not cash, another question arises. Thus defendant returns, this time tacitly, to its fallacy of assuming the plaintiff's stock loss to have had no value. In fact, its value was the benefit conferred, the full amount of the tax savings. The government did not take less than was due it.

debt to a third party by the use of B's property or services, B is entitled to restitution, at his election, either of the value of the property or services so used or of the amount of the debt discharged. The rule is the same where A's conduct as respects B is at fault, although not tortious. *Restatement,* Section 155.

The controlling principle is that "one is entitled to recover for benefit conferred unless he intended to make a gift or acted officiously." (2 Scott on Trusts, sec. 269.3, p. 1520; see O. B. 55, and 66 et seq.)

Truncale v. Universal Pictures, Inc., 76 F. Supp. 465, 469 (quoted O. B. 72) and the *Kentucky Cave* case, *Edwards v. Lee's Adm'r,* 96 S.W.2d 1028, 265 Ky. 418 (discussed O. B. 69-71) refute defendant's attempt to limit plaintiff's recovery to a nominal sum.

Defendant would circumvent the *Kentucky Cave* case by asserting that it was a case of trespass (Br. 46). But the court refused to treat it as a case of trespass because, had it done so, there could be no recovery since there was no "damage." It therefore specifically and in terms decided the case as one of unjust enrichment in which recovery is measured by defendant's profit (pp. 1030-1032).

Moreover, that case cannot be so distinguished because here defendant's use of plaintiff's rights was not consensual. Long before the plaintiff's loss was allowed as a deduction by the government in 1947, defendant had been put on notice of plaintiff's claims by the filing of the suit and by the letter of May 5, 1947 (see O. B. 22). Nevertheless defendant persisted in using plaintiff's loss in defiance of its claim.*

Defendant would distinguish the *Truncale* case as a mere ex-

---

*In the *Kentucky Cave* case defendant was a "trespasser" and a "wrongdoer" and his act "wilful" only in the sense that he had gone onto the land of another and had not done so accidentally. He did not know that the land was another's. His trespass was far beneath the surface and not until plaintiff sued, upon a "guess," and obtained a survey by court order did anyone know that any part of the cave underlay plaintiff's property (see earlier proceedings, *Edwards v. Sims,* 24 S.W.2d 619, and particularly facts stated at 623).

ample of the rule that corporate directors are not allowed to profit at the expense of their corporation. But the court stated that it had to decide the case on more fundamental principles, because it did not fall within the class of cases where a corporate officer has taken for himself what could have been a corporate advantage or opportunity (76 F. Supp. at 468, 469). The plaintiff was held entitled to all of defendant's gain because "the corporation has been deprived of its freedom of action" even though the corporation could not itself have obtained all of such gain (p. 469).

Defendant denies that there was an appropriation of plaintiff's rights, and is so bold as to assert that what was done was "routine" (D. Br. 21). It could not be routine under a newly enacted law, where the situation was "paradoxical," where the plaintiff by final court decision had just been decreed to have experienced a $75,000,000 loss and where the amount of taxes involved was $17,000,000. Defendant never did the normal thing of openly discussing the matter with independent representatives of plaintiff: it ignored plaintiff's existence save to utilize it for its own purposes.

The statement of facts in defendant's brief contains a number of assertions on this subject that are immaterial or erroneous. We shall not reply to them in detail, because on this issue the trial court made a finding of fact in favor of plaintiff. It found that "there is a preponderance of evidence in favor of plaintiff's contention of duality of control" after stating plaintiff's contention to be that

> "defendant through its officers and attorneys had controlled * * * plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant" (see O. B. 9).

Defendant's assertion that "the final decisions were necessarily made by the Corporation when it filed the returns" (D. Br. 34) is amazing in the light of the proven facts that the president of the corporation, who was in the pay of defendant, merely signed what was put before him by the defendant's tax attorney.

Defendant's discussion treats Mr. Curry as if *he* were the plaintiff, or as if his capacity were only that of an officer of the plaintiff, when in fact he was in defendant's employ, was also its officer, and his principal work was for it.* Similarly, his competence is exalted, and the notion is sought to be conveyed that he managed and controlled tax matters for the plaintiff, when in fact he acted in a clerical capacity, as office manager, and as a "signing" officer who "signed whatever documents they told you to sign" (642). The admitted competence with which he performed these limited functions did not exalt him into a directing figure, for in all other respects he was, as he admitted in response to a question from the bench, a "figurehead" (646-7).

Matters pertaining to taxes were put before him for signing after they were prepared by others over whom he had "supervision" only in the sense that he was office manager, and he had no real understanding of them (e. g., 807-809).

The truth as to the preparation of the tax returns is disclosed by memoranda passing between Mr. Coulson and Mr. Polk, the defendant's tax attorneys. Mr. Coulson wrote:

> "Actually, I happen to know that the only person over at the Corporation office here in New York who has any knowledge of taxes is a girl who is primarily Schumacher's Secretary [Valouch]." (539 P. 38)

Polk replied that "only the lady referred to had any part in the preparation of the return" (540 P. 384).

The fact, as both Curry and Polk testified, is that the returns were prepared by Valouch and Polk's accountant, Reilly, under Polk's direction (1403) and signed by Curry because told that they had Polk's approval (823).

Defendant argues that some of plaintiff's officers were both

---

*Defendant asserts (D.Br. 16) that Curry was never an officer of the defendant after its reorganization. The fact is otherwise. He was its vice president, assistant secretary and assistant treasurer until April 30, 1945, months after the revestment (P. Ex. 2-A, chart), was in the retainer of its tax counsel until late in 1947, and at all times received a pension from it (O.B. 13).

competent and informed (D. Br. 32). But consider the situation of the individuals named. Mr. Schumacher was one of the defendant's trustees. Mr. Campbell was counsel for defendant and the trustees and received his compensation from them (P 2A, reproduced in our opening brief).

Messrs. Wood and Osborn never knew until 1946 that plaintiff's stock loss was being used in the consolidated returns. It is no answer to say that these two understood that consolidated returns were being filed (D. Br. 16, 17, 34). The idea of using the loss in such returns was a mere speculation of a possibility when it was first thought of in May, 1943, "commented on rather than suggested * * * since it is paradoxical" (see O. B. 17), rejected by the defendant's counsel for that reason until December, 1943 (1448, 1484) and never brought home to Messrs. Wood or Osborn (see Osborn, 1022, 1023; Wood, 1129-1131).

Defendant discusses Mr. Nicodemus in order to show, it seems, some sort of knowledge by him of the filing of consolidated returns.* His knowledge, whatever it was, cannot affect plaintiff. He was only an attorney for it, not an officer or director, and he was also an attorney for the defendant. Even if plaintiff's officers and directors had known of the utilization of its loss, had realized the legal and economic consequences, and with that knowledge had attempted to give away its rights, they could not bind it, because it was not represented by independent officers, and because any attempt to give away its rights without the consent of its stockholders would be beyond its powers (see O. B. 55, 56).

For the same reason defendant's discussion of a casual conversation of Mr. Nicodemus with some attorneys who represented no parties in this case is pointless (D. Br. 34). The trial court dis-

---

*The manner in which defendant seeks to show his knowledge is shown by the statement (D.Br. 10) that "Mr. Curry understood that Mr. Nicodemus knew * * *." Mr. Curry's suppositions are irrelevant.

Defendant denies that Polk sent the "paradox letter" to the defendant and asserts that he sent it to Curry and that Curry sent a copy to Nicodemus (D.Br. 16). The letter was addressed and sent to Curry as defendant's vice president (588) and, as such, he transmitted it to Nicodemus as defendant's attorney (1884).

missed the subject as quite irrelevant (1075).* In fact, in these conversations Mr. Nicodemus did not have in mind the use of the stock loss (1071).

Defendant even seeks to clothe its present refusal to do equity in the mantle of the general esteem all bear for Judge Sloss. More than once it says that Judge Sloss represented the plaintiff (D. Br. 6, 34). But Judge Sloss was plaintiff's attorney on a specific assignment, to oppose the Plan of Reorganization. He had no other function and was interested in nothing else. He knew nothing whatever about the tax matter (1603-5, 1611-14).

D. The Fallacy That Plaintiff Was Under a Duty to Make a Gift of Its Rights to Defendant.

While defendant denies that it was in the position of a fiduciary toward plaintiff, it does not state why. Instead it asserts that plaintiff had fiduciary responsibilities to the defendant! This contention rests on the fact that plaintiff had once been the parent corporation. Its fallacies are self-evident. What makes one a fiduciary is the element of dominance and the exercise of control and management (see O. B. 60). Here:

1. Plaintiff had no control whatever as a stockholder or otherwise. It had had no share in management after the trustees were appointed in 1935. And the Plan of Reorganization cut off any possibility that control, management, or financial interest would ever return to it.

2. Plaintiff had become a total economic stranger to defendant.

Defendant ignores the unique and distinguishing fact of the case, the severance of the economic unity. Plaintiff at the times involved here had no control over, management of, financial interest in, or duties toward defendant.†

---

*The Court said (1075, 1076):

"I do not see that when this witness learned about any of these things has any relationship to the question that you are presenting here. * * * I would much rather hear your arguments and all the arguments on the important and vital issues of this case than all this stuff about what conversations this witness had with some lawyer on a train going to Washington."

†For a time plaintiff held certain pieces of paper, quondam stock certificates, but they had been judicially declared to represent no stock interest in

Defendant's argument is simply a bold assertion that plaintiff was under a duty to make a gratuitous donation of its rights to the defendant for the latter's enrichment. This is not reasoning. It merely assumes the answer to the issue involved in the case.

The same fallacy underlies Part III of defendant's brief, where it is contended that plaintiff's claim is "inequitable" (D. Br. 65-67, also 59, 60). It is argued that the pre-reorganization creditors of defendant were not paid in full, and that creditors have an absolute priority over stockholders. But the conclusion sought to be drawn is a non-sequitur. The creditors *did* receive absolute priority. Plaintiff, the stockholder, had its equity completely wiped out, and the old creditors became the stockholders of the reorganized company as well as its bondholders.

Plaintiff does not ask that it receive an equity interest in that company. It seeks an accounting for use of *other* rights or assets of the plaintiff to the defendant's enrichment, rights and assets not involved in the reorganization. Creditors of a reorganized company, after squeezing out the former shareholders, have no right to seize other property of the former shareholders. Could the reorganized defendant company seize $17,000,000 cash of the plaintiff to pay defendant's taxes and escape the duty to account, because pre-reorganization creditors had never been paid in full? Obviously not. (See discussion, O. B. 88-95 and page 26, infra.*

---

defendant. And it did not even hold these at the times the tax returns were filed.

Defendant argues that obligations of a fiduciary may continue after termination of the relationship, but this could be true only so long as duties of the position remained to be performed. Plaintiff had no such duties in the premises toward defendant.

*As part of this argument defendant asks the Court to take judicial notice of stock market quotations of its stock in 1949 and 1950 (D.Br. 67)! Defendant offered evidence of quotations in 1945 and 1946, and that evidence was excluded (1579-1583). It complains that creditors took stock under the Plan of Reorganization on the assumption that the preferred stock was worth $100 per share and the common $57. If the Court could take judicial notice, which we deny, it would find that the preferred stock sold as high as 101 (in April 1946) and the common stock as high as 57⅛ (in July 1945), dates shortly following the consummation of the reorganization, all as shown by the excluded evidence (2042, 2043). The later vicissitudes of the market cannot be relevant.

Even controlling stockholders of a corporation are under no duty to make a free-will offering to it or to its creditors of other property belonging to them. Much less so are ex-stockholders.

In this connection defendant makes certain invidious assertions. It states that when plaintiff controlled defendant it caused the latter to sell securities to the public, and that defendant went into bankruptcy because of plaintiff's unsuccessful management (D. Br. 4 and 66). The fact is the plaintiff was itself controlled in those years by the James interests who owned 61% of its common stock and 8.8% of its preferred stock (admitted, D. Br. 3). These were the controlling human agents responsible for what occurred. As the result of defendant's reorganization, the James interests became the controlling power in defendant. If plaintiff's suit is defeated, the James interests will profit greatly (see O. B. 11, 13, 14).

Defendant argues that the bankruptcy court could have compelled the plaintiff to join in consolidated returns for defendant's benefit (D. Br. 40). The reason it gives for this contention is that a bankruptcy court has the powers of a court of equity—an irrelevance, since (1) a bankruptcy court has those powers only within the limits of its bankruptcy jurisdiction, and (2) defendant fails to adduce any basis for an equity to compel plaintiff to join in returns for defendant's benefit. We have shown in our Opening Brief that there would have been no such equity. (See O. B. 51-55.) We also showed that the bankruptcy court would have had no jurisdiction to enter any such order (O. B. 52).*

---

*The controlling cases on jurisdiction are *Benton v. Callaway,* 165 F.2d 877, and *Callaway v. Benton,* 336 U.S. 132.

Of these cases defendant merely says (D.Br. 41) that they involved the power of the reorganization court over a stranger to the proceedings, and that plaintiff here was a party. But plaintiff appeared only to present its views in opposition to the Plan of Reorganization. It thereby submitted itself to the jurisdiction of the bankruptcy court only to assert its claims, as stockholder or bondholder, against the debtor, not to give the court jurisdiction over demands which a debtor might assert against it. In the *Callaway* case the litigant, South Western, had appeared in the reorganization proceedings to ask that its lease be adopted by the reorganized debtor (see 336 U.S. 132 at 134 and 135), and it was also a creditor in the proceedings (p. 146). Yet the Court of Appeals said that those facts gave no

Revealing defendant's attitude are its arguments (D. Br. 40) that *if* it had openly come to plaintiff to ask for the use of plaintiff's rights, it would have been a "levy of tribute" or "exacting a price for a signature" for plaintiff to decline to give away its valuable rights and its assertion that equity does not countenance hard bargains. Here defendant gave plaintiff no opportunity to bargain. Taking advantage of the fiduciary relationship, it appropriated what belonged to the plaintiff.*

II.

THERE IS NO MERIT TO DEFENDANT'S CONTENTION THAT PLAINTIFF'S CLAIMS, THOUGH VALID, SHOULD BE DENIED BECAUSE OF THE REORGANIZATION PROCEEDINGS.

The last part of defendant's brief is devoted to the contention that even if plaintiff "had a valid claim" it has been barred by the reorganization proceedings, because not presented to and approved by the Bankruptcy Court (D. Br. 68-83). Defendant argues that even though the plaintiff and its stockholders are justly entitled to recover $17,000,000 from the defendant, they are to be denied that recovery, because the decree of the Bankruptcy Court destroyed their claim.

This harsh contention is sustained by neither the facts nor the law.

---

jurisdiction to the reorganization court to compel it to convey rights to the debtor. 165 F.2d 877 at 882. And the Supreme Court agreed. 336 U.S. at 146.

*If A covets something of value belonging to B, the parties may by mutual agreement determine the terms and consideration upon which B will accede to A's desires. *Sekulow v. 11th & F. St. Valet, Inc.,* 162 F.2d 19 (D.C. Cir. 1947); 5 *Williston on Contracts* (Rev. ed.), Sec. 1606; *French v. Shoemaker,* 14 Wall. 314, 333; *Truncale v. Universal Pictures, Inc.,* 76 F. Supp. 465.

The cases cited about "exacting a price for a signature" are cases where A sells or assigns something to B "who had bought and paid for" all A's rights and interests and to make the sale effective a signature to some form was later necessary (e.g., *Kelley v. Caplice,* 23 Kan. 474) or cases likened by the court to selling a vote on a public question (*Lain v. Rennert,* 32 N.E.2d 375 (Ill. App.)).

A. Plaintiff's Claim Is Not Remotely in Derogation of the Policy of Section 77 of the Bankruptcy Act or the Purpose of Defendant's Reorganization.

Defendant first asserts that plaintiff's claim is contrary to the policy of Section 77 of the Bankruptcy Act (D. Br. 68-71). The assertion lacks merit. We so showed in our Opening Brief (pp. 88-95), and we now note, merely by way of recapitulation, the following facts. The tax savings had no bearing whatever on the plan of reorganization of the defendant. Those savings were unanticipated. The Plan contemplated that the taxes be paid. It was approved by the court, consented to by the creditors, confirmed and put into effect before anything was done from which the savings arose.* Thereafter plaintiff's rights were appropriated to give defendant an unexpected and unjust enrichment.

There is no policy in Section 77 that after a reorganization the reorganized company may appropriate rights or assets of another to its own enrichment without a duty to account.

B. Plaintiff's Claims Arose After the Revesting of the Railroad Properties in Defendant.

The properties revested in defendant on December 31, 1944, and the trustees then surrendered control of operations to it (O. B. 26).

---

*Defendant's brief (p. 75) asserts that persons who participate in the reorganization as creditors or otherwise are entitled to an exact statement of the assets available for the new concern and a precise definition of its liabilities, and cites *In re Colorado & S. R. Co.*, 84 F. Supp. 134. That case arose under the *McLaughlin Act* (56 Stat. 787), which inserted a new and temporary chapter (Ch. XV) into the Bankruptcy Act. The McLaughlin Act contained special provisions for notice to the Secretary of the Treasury relative to taxes, binding the United States if it failed to appear within a given time (Secs. 722 and 738). The case did not involve claims arising from a trustee's operations but pertained to taxes accrued before the court acted on the petition which commenced the proceedings. What the court said was that if the United States had presented a claim for additional taxes, it would have made the plan of adjustment unacceptable to the creditors who otherwise gave the assents without which the plan could not have been approved.

In the present case, the tax savings arose from acts occurring after the plan was approved, consented to, confirmed and consummated.

Patently, if the plaintiff's claims arose afterwards, the reorganization proceedings could not bar them.

Liabilities and obligations arising from use of another's property or rights by a post-reorganization company may be enforced without impairment by reason of the reorganization proceedings. *Seabord Air Line R. Co. v. Savannah Union Station Co.*, 181 F.2d 267 (5 Cir.).

Plaintiff's claims did arise after the reorganization. This is self-evident as to claims with respect to the 1944 taxes and the refund of 1942 taxes. The claim for refund was filed in March, 1945—2½ months after the reorganization was over—and the 1944 return was filed in June, 1945. The trustees had nothing to do with either. The filing of these papers was strictly the act of defendant.

Defendant argues that the income to which the 1944 return and the claim for refund pertained had accrued while the railroad was being operated by the trustees. But the obligation to pay the taxes on that income was assumed by the defendant by means of the Assumption Agreement (see O. B. 90). The liability thereafter remaining was that of the defendant, not the trustees. It was the defendant and not the trustees who then utilized plaintiff's loss and rights to avoid paying taxes and to discharge that liability.

As respects the 1943 taxes, although the returns were filed in July, 1944, the claim for recovery or an accounting of the tax savings relative to that year could not accrue before there were tax savings, i. e., not earlier than August, 1947, when the government finally accepted the returns pursuant to the settlement. And it accrued when defendant refused to account. The failure to account was the wrongdoing.

When the trustees turned over the assets to the defendant in December, 1944, among those assets were $7,100,000 in government bonds, earmarked as a reserve for the payment of 1943 taxes. The tax savings resulted from the subsequent acts of the defendant in adopting the returns as filed, and in the name of plaintiff prevailing upon the tax authorities to accept them. For

example, defendant's Annual Report for 1944, issued in May, 1945 (5 months after it was out of reorganization), refers to the reserves as maintained to protect the defendant in the event of "a ruling adverse to the Company's contention that it was not liable for any Federal income or excess profits taxes for the calendar year 1943 and the first four months of 1944" (514 P. 20-C). It will be noted that mention is here made of the Company, not of the trustees.*

As defendant's witness, Mr. Polk, testified, "this was a doubtful item and it was not until the Bureau had finally allowed the settlement that I knew that we had the benefit of it" and "* * * any action [about tax savings] was premature until the liability to the government was determined. You cannot calculate any savings until you know * * * the liability under the returns as filed" (1459, 1460).

The Bureau's field examiner concluded in May, 1946, that the deduction should be disallowed.† Tax counsel then took the matter up with the Internal Revenue Agent in Charge. In order to do this, he had to procure a power of attorney from the plaintiff, through Mr. Curry (1424). Filing the power of attorney was an act of the defendant, not of the trustees, and but for it there would have been no tax saving. The first letter to the Agent was written May 31, 1946 (O. B. 20).

After an adverse conclusion of the Agent, the matter was

---

*The 1943 returns had been filed, not in the name of the trustees, but in the name of defendant as an affiliate of plaintiff, and the returns were signed, not by the trustees or by Mr. Elsey as their agent, but by him as defendant's president. (See in P. 4A the "Return of Information and Authorization and Consent of Subsidiary Corporation Included in a Consolidated Income Tax Return.")

The Plan of Reorganization itself contemplated that, vis-a-vis the creditors who were to become the stockholders of the reorganized Company, the income after January 1, 1939 was to be treated as if the reorganized Company had come into ownership and possession of the properties on January 1, 1939 (2183 D. 23A, para. 7).

†The government's audit of the returns did not even become active until the latter part of 1945 (1419), the field examiner did not complete his work of examining the returns until May 1946 (1423), and the audit was not completed by April 1947 (1788).

taken to the office of the Commissioner of Internal Revenue in Washington and there settled (1426, et seq.). None of this involved any acts of the trustees.

Before the tax settlement in 1947 defendant had already been advised in writing that plaintiff expected an accounting of the tax savings, if defendant succeeded in having the government accept the returns as filed (O. B. 22). Defendant had its choice then whether to seek to have those returns accepted or not. The tax savings were the result of its action at that time.

C. If Any Part of Plaintiff's Claims Arose Before Revesting, the Reorganization Court Required Them to Be Assumed, and They Were Assumed, by Defendant; the Court Made No Order Barring the Claims.

Defendant seeks to avoid the fact that the plaintiff's claim relative to the 1943 taxes accrued after the close of the reorganization proceedings by arguing that theretofore it was executory or contingent, and it then argues that the claim is barred.

The argument is permeated with numerous erroneous assumptions of fact and fallacies of law, as we shall now show.

In the first place, if those claims accrued before December 31, 1944, or existed even contingently, they were expressly assumed by defendant.

The bankruptcy court decreed no bar of claims except such as may be found in the "revesting order" of November 27, 1944 (36). Paragraph 11 of that order fixed the date of the consummation of the Plan as December 29, 1944, and provided that "the said Railroad Company shall thereupon be forever released and discharged from all of *its* debts, obligations and liabilities, *except as herein provided*" (51, 52).

This was no bar to the present claim, for two reasons. First, the bar relates to "its" debts, i. e., those of the railroad company existing at the time reorganization proceedings commenced in 1935, not to claims arising from the trustees' acts (see pp. 34-39, infra). Second, the revesting order expressly excepted from its bar certain obligations. In paragraph 8 it "authorized and directed" defendant "to execute and deliver * * *

(a) agreement providing for the assumption of certain obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, substantially in the form attached to this order as 'Exhibit D', the form and provisions of which are hereby approved;" (45, 46).

An Assumption Agreement was then executed by defendant in December, 1944 (see O. B. 26). Therein defendant agreed to:

> "2. *Assume* any and all outstanding current liabilities and obligations incurred by said Trustees * * * and *generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business,* including liabilities and obligations hereafter arising up to midnight December 31, 1944." (1711, 1713.)

Defendant tries to restrict this assumption to less than *all* the trustees' obligations, by reference to various inapplicable language of the revesting order and the Plan of Reorganization (D. Br. 77). But the Assumption Agreement says "all," it is in the exact form attached to the revesting order and, in finding (e) of that order the court found that this agreement providing

> "for the assumption of obligations, liabilities * * * which are to be assumed by the reorganized company pursuant to the plan of reorganization, is consistent with and conforms to the plan of reorganization * * *." (40.)

Not only is the language of the agreement all-comprehensive, it was so construed by the court. By order of May 21, 1945, approving the trustees' final report, the court found in paragraph 4 that by the Assumption Agreement the "Debtor Company assumed and agreed to perform *all* contracts, leases, agreements, liabilities and obligations of the Trustees remaining in effect on December 31, 1944" (1987, 1988).

Defendant's attempt to qualify the breadth of the Assumption Agreement is based, essentially, on the provisions of paragraph 10 of the revesting order that defendant was to pay expenses and

costs of administration in such amounts as were determined by the court (D. Br. 77). Defendant tries to squeeze plaintiff's claims into the pigeonhole of expenses of administration and bar them for lack of presentation to the bankruptcy court. The argument is without merit.

As used in the particular reorganization proceedings the term "expenses of reorganization" was not co-extensive with all obligations arising from the trustees' acts. This fact is apparent from many provisions of the Plan and the Revesting Order, but it is sufficient merely to review subdivision Q of the Plan, which defendant quotes (D. Br. 78). That subdivision treats of two different groups of claims: (1) those that must be paid in cash or that the reorganized company must agree to assume by entering into an express assumption agreement, and (2) those that it must be deemed to have assumed, i. e., in regard to which an assumption would be implied.

The second group consisted of express contracts of an executory nature extending beyond the reorganization and remaining to be performed thereafter. Patently it is not here involved, although defendant refers to it (D. Br. 78).

The first and pertinent group includes four kinds of claims:

(a) Claims existing against the debtor prior to the commencement of the bankruptcy and entitled to priority over the mortgages;

(b) current liabilities;

(c) "obligations incurred by the trustees of the properties of the debtor during the reorganization proceedings";* and

(d) expenses of reorganization.

Paragraph 10 of the revesting order effectuates the provisions of the Plan concerning expenses of administration. But it is paragraph 8(a) which effectuates the generality of the provisions of the Plan relative to "obligations" (46).† And that paragraph

---

*In its trial brief (p. 126) defendant conceded that " 'obligations' may have a different scope" than "current liabilities." In its present brief it blandly treats them as synonymous.

†Defendant even discusses paragraph 15, which relates only to assertion of liens or the attachment of property (D.Br. 79).

required the defendant to execute the prescribed Assumption Agreement and thereby to assume claims of any character, "whether heretofore *or hereafter* asserted arising out of * * * their [the trustees'] conduct of the debtor's business," and it did not limit the assumption to obligations first presented and approved by the bankruptcy court. The explicit mention of claims "hereafter asserted" so shows.

The revesting order, and the petition on which it was granted, were both prepared by Mr. Coulson's firm (36, 1699). That firm is now counsel for defendant in this case. Mr. Coulson never supposed that the order had the meaning that he now advocates. On November 15, 1948, he submitted his bill to defendant for $300,000 for tax services rendered in part to the trustees in connection with the subject matter of this suit (1749). If the Assumption Agreement covered only claims first presented to and approved by the reorganization court, Mr. Coulson's claim would be barred.

Defendant notes that in some cases it has been held that for certain purposes taxes accruing during receivership are expenses of administration. Apparently defendant deduces, although silently, that plaintiffs' claim must be regarded as of the same character as the obligation to pay taxes.

The argument is self-defeating. The term "costs and expenses of administration" as used in the defendant's reorganization proceedings did not include taxes. The Plan explicitly provided (233 I.C.C. at 455) that

> "Notwithstanding any other provisions of this modified order, the reorganized company shall assume the liability for, and shall pay in full in due course, any and all taxes due to the United States from the debtor or the debtor's trustees for any taxable period prior to the date of the confirmation of the plan, *whether or not proof thereof has been made in the proceeding and without prejudice by reason of not having made proof thereof.*"

Similarly, while the revesting order referred to "costs and expenses of administration" in paragraphs 10 and 20, it referred

to taxes in paragraph 9 and it there provided that the defendant must

> "assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, *whether or not proof thereof was made in said proceeding and without prejudice by reason of such proof not having been made.*" (49)

The notion that the obligation to account to the plaintiff could fall within the narrow confines of the expression "costs and expenses of administration" has no substance. A receiver's office expenses or the salaries of his clerical help are expenses of administration, but if the receiver robs a bank or seizes and sells the property of another to obtain funds to pay his office expenses or clerical salaries, the liability to account to the owner can hardly be so denominated.

FINAL ORDER.

Defendant also refers to the final order of March 28, 1946 (D. Br. 80). But the defendant, its assets and operations had been out of the trustees' hands since December 31, 1944, and the "final order" merely settled the personal accounts and formally closed the files of the court on the case. So far as any bar is involved, that order merely adopted the provisions of the revesting order of November, 1944. Therefore, it barred only such claims as existed on or before December 31, 1944, and it exempted from that bar all claims exempted by the revesting order, i. e., those covered by the Assumption Agreement.

D. Plaintiff's Claims Did Not Have to Be Approved by the Bankruptcy Court.

Defendant argues that plaintiff's claims, though valid, are barred by failure to have them approved by the bankruptcy court.

As respects the 1944 returns and the claim for refund there is not the remotest basis for the contention. The property had already been surrendered to the defendant. As said in *Texas and Pacific Railway Company v. Johnson,* 151 U.S. 81 at 103:

"* * * we are aware of no principle which would justify us in holding that a court, under the circumstances which existed here, could part with its jurisdiction over property by the complete surrender thereof to its owner, and at the same time constructively retain jurisdiction over such property so as in that respect to bind those who would otherwise be unaffected by its orders."

Here the reorganization court did not even purport to reserve jurisdiction to supervise claims arising after the revesting.*

Nor is defendant's contention correct as respects the 1943 taxes. A basic fallacy is its failure to observe the distinction between obligations of the debtor existing at the onset of the proceedings and obligations arising from acts of the court's officers.

At the moment when any plan of reorganization under Section 77 of the Bankruptcy Act is to be consummated, four possible classes of liabilities may be in existence: (1) Personal liability of the *debtor itself* for *its* own debts and liabilities, i. e., debts existing at the commencement of the reorganization proceedings; (2) liability of the *property and assets* in the hands of the trustees to pay these debts and to pay the claims of stockholders, as stockholders; (3) personal liability *of the trustees* to pay obligations arising from *their* operations; (4) liability of the *property and assets* to pay the latter class of obligations.

The policy of the law is to discharge claims of the first three classes but not of the fourth. The integrity of the courts requires that claims arising from the acts of their officers be paid, and it is settled practice that such claims are assumed by the party to whom the assets are transferred.

Subdivision (f) of Section 77† provides:

---

*Nor could it. As said in *Reese v. Beacon Hotel Corporation,* 149 F.2d 610 at 611: "* * * reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." Here the plan was formulated, approved and confirmed before anything was done that eventually led to the tax savings. Cf. *Callaway v. Benton,* 336 U.S. 132.

†Title 11 U.S.C.A. Sec. 205 (f), p. 190.

"The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of *all claims of the debtor, its* stockholders and *creditors,* and the *debtor* shall be discharged from *its* debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention * * *. Upon the termination of the proceedings a final decree shall be entered *discharging the trustee* or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case."

Thus, while provision is made to discharge the debtor and the assets from claims existing at the commencement of the reorganization and to discharge the trustees personally, no provision is made for freeing the assets from liabilities arising from the trustees' operations.

Here, the Assumption Agreement carried out the policy of the law by imposing on defendant the affirmative duty to pay such liabilities.

The provisions of Section 77 "carr[y] with [them] the application to railroad reorganizations of decisions and authorities originally applicable to equity receiverships." 5 *Collier on Bankruptcy* (14th ed.) P. 493, citing *In re Southwestern Ry. Co.,* 17 F. Supp. 68, aff'd 88 F.2d 163.*

---

*Proceedings under Section 77 are essentially enlarged receivership proceedings, freed of territorial limitations and with title to the debtor's assets vesting in trustees. 5 *Collier,* p. 467. Unlike ordinary or traditional bankruptcy proceedings, their purpose is not to liquidate the debtor but to rehabilitate it and to preserve its operations. 5 *Collier,* p. 468; *Thompson v. State of Louisiana,* 98 F.2d 108 (8 Cir.); *Lowden v. State Corp Comm'r,* 76 P.2d 1139; 42 N.M. 254.

Section 77, subd. (a) (11 U.S.C.A., Sec. 205(a) at p. 179) confers on the court "all the powers not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose." Subdivision (c) (2) provides that the trustee "shall have all the title and shall exercise * * * to the extent not inconsistent with this section, if authorized by the judge, the

The principles in railroad receiverships were well settled when Section 77 was enacted. When the assets of the debtor were sold to pay its debts, it was the practice to require the purchaser to assume all liabilities arising from the receiver's acts, and the purchaser became personally liable, thus preserving the claims, although the receiver himself was personally discharged. Cf. *Hanlon v. Smith,* 175 Fed. 192; 1 *Clark on Receivers* (2d ed.) Section 494, at p. 677. When the assets were not sold but were returned to the debtor, enriched or bettered by the receiver's acts or operations, the party receiving them was held liable for the claims arising out of the receiver's acts even though the claims were not presented to the receivership court within a time fixed by it. An assumption arose by implication of law. Cf. discussion in *Bartlett v. Cicero Light, Heat & Power Co.* (Ill.), 52 N.E. 339 at 341, 342; 177 Ill. 68.*

Leading cases are *Texas & Pacific Railway Company v. Johnson,* 151 U.S. 81, and *Texas & Pacific Railway Company v. Bloom,* 164 U.S. 636. There, during receivership the earnings of the railroad were applied to payments of debts and to betterments. The order directing the receiver to deliver the assets back to the railroad discharged him as of the date of revesting and contained a provision directing claims to be filed on a day certain under penalty of being forever barred (164 U.S. 638, 639).

The Supreme Court held that since an order barring claims arising from the Receiver's acts would be highly unfair, any bar order entered should be strictly construed so as not to have that effect. The court emphasized that two purposes are to be served

---

powers of a receiver in an equity proceeding * * *" (11 U.S.C.A. Sec. 205(c) (2) at p. 183).

Here the powers of a receiver in equity were conferred on the trustees by order of November 9, 1935 (1923, 1928 D 22).

*See also *Glenn on Liquidation,* Sec. 165, pp. 273, 274; *Clark on Receivers,* Sec. 495, p. 677; *Stuart v. Dickinson,* 235 S.W. 446, 456; 290 Mo. 516; *Anderson v. Chicago, R. I. & P. R. R. Co.,* 175 N.W. 583; 189 Iowa 739. A full discussion appears in 45 *Am. Jur.* 276, Sec. 345. Among other things it is there said:

> "Furthermore, a railroad company is liable for any claim which should have been paid by the receiver out of the earnings of the railroad, although the claim is not established by intervention within the time fixed by the order of the court."

when a receivership is to be closed: (1) The receiver should be protected; but (2) the court should see that all just claims arising from his conduct are protected.

These purposes were attained by construing the bar order as cutting off the receiver's personal liability and precluding subsequent recourse in the receivership proceedings but as not precluding recourse in any other competent forum against the party receiving the assets, despite lack of filing of the claims in the receivership court. An implied assumption by the company arose from the receipt of the assets which had been enriched by the receiver's acts.* *Johnson,* 151 U.S. at 104 to 106; *Bloom,* 164 U.S. at 640, 641.

Plaintiff's position here is stronger than that of *Bloom* or *Johnson.* In those cases there was no express assumption of the receiver's obligations. The assumption was implied on principles of unjust enrichment. Here we not only have all the facts of enrichment sufficient to create an implied assumption, but we also have an express agreement of assumption. In those cases, too, while the assets were enriched, there was no relation between the enrichment and the particular claims asserted. Here, not only were the assets greatly enriched and bettered upon revesting in defendant (see O. B. 28, 94), but there is an immediate and direct causal relationship between the activities giving rise to the obligation and the increase of assets in the defendant's hands. Defendant's assets are enriched by the precise amount of the tax savings. In those cases there was an order directing claims arising from the receiver's acts to be presented on a given date under penalty of being barred. Here there was no such order.

Defendant asserts (D. Br. 70) that "reorganization must put an end to all outstanding claims" and quotes a passage from *Duryee v. Erie R. Co.,* 175 F.2d 58 and one from 6 *Collier on Bankruptcy* (14th ed.) Sec. 11.18, pp. 3922-24, relative to proceedings under Chapter X (former Sec. 77B). But the *Duryee* case was speaking "of a claim existing prior to the reorganization

---

*Cf. *California Civil Code,* Section 3521: "He who takes the benefit must bear the burden."

proceedings" (p. 61 and headnote 1). And Collier's reference to the discharge of "liabilities incurred during reorganization" relates to obligations incurred by the debtor itself, not to those arising from the trustees' acts. This is shown not only by the language of the text but by the only case cited by Collier in support of the phrase, *Peavy-Byrnes Lumber Co., Inc. v. Long-Bell Lumber Co.,* 55 F. Supp. 654.

ABSENCE OF NOTICE TO PRESENT CLAIMS.

If the court had power under Section 77 to bar claims arising from the trustees' acts for failure of presentation, it could not exercise that power without giving notice.

Any attempt to do so would violate due process. *In re Central R. Co. of New Jersey,* 136 F.2d 633 (3 Cir.), cer. den. 320 U.S. 805. *In re Glenn-Colusa Irrigation District,* 62 F. Supp. 65 (N.D. Cal.). "Notice is a very essential feature of the Bankruptcy Act if the rights of creditors are to be limited or curtailed," *Investment Building v. Finance Co. of America,* 105 F.2d 345 at 347 (3 Cir.). And see *Texas & Pacific Railway v. Johnson,* 151 U.S. 81 at 103.

Moreover, if there is any power in a court under Section 77 to bar claims arising from the conduct of receivers or trustees, that power is governed by subsection (c) (8), which prescribes that

> "The judge shall cause reasonable notice of the period in which claims may be filed * * * to be given creditors and stockholders by publication or otherwise."

Here no notice was given to claimants to present any claims arising from the trustees' operations, as distinguished from claims existing against the debtor at the time proceedings were instituted in 1935. Nor did the court make any order directing that such notice be given.

It is obvious why no such order was made: No bar was intended.* As a matter of construction, the absence of such an order

*In *Investment Building v. Finance Co. of America,* supra, where a notice was given to certain class of creditors but there was no order requiring it to be given, that fact was held to show the court had no intention to bar the claims of the class.

and of notice confirms that the Assumption Agreement was intended to be as broad and as complete as its language indicates.*

Defendant relies on this Court's decision in *McColgan v. Maier Brewing Co.,* 134 F.2d 385 (D. Br. 74). There an involuntary petition in ordinary bankruptcy had been filed against a corporation. It was operated by a receiver until a plan of composition was approved, the business was restored to the debtor, and the receiver discharged. Later it went into 77B proceedings, and the question was whether a claim for state franchise taxes for the years when the business was being operated by the receiver in the first bankruptcy should be recognized, the claim not having then been presented in the first proceedings. This Court twice emphasized that notice had been given directing such claims be filed under peril of being barred.†

Moreover, there was no showing that during the receivership there had been any enrichment of the estate by the receiver's operations as by devoting funds received from the operations to payments of debts or to the making of improvements or betterments.‡

Defendant's argument ignores the element of enrichment of the trust estate by the trustees' acts and the revesting of the estate, so enriched, in the defendant. In the *McColgan* case this Court

---

*Defendant quotes a passage from *Collier on Bankruptcy* relative to discharge of holders of claims who have had no notice (D.Br. 70). This pertains to cases where the court directed notice to be given and it was given as prescribed, but where there was no showing that a particular claimant had received it. Since the identity of creditors may be unknown, notice may not in fact come to a particular claimant's attention. It is to this situation only that Collier's statement applies, as shown by his principal citation, *North American Car Corporation v. Peerless W. & V. Mach. Corporation,* 143 F.2d 938 (2 Cir.).

†It said:

"During the course of the proceedings numerous notices were published in Southern California newspapers, pursuant to court order, directing all persons having claims to present them" (p. 386).

"* * * Persons having demands against the receiver or claiming rights to participate in the estate were repeatedly given notice to come in and make their demands known" (p. 388).

‡This Court concluded by saying (p. 388), "It is said that the corporation was unjustly enriched through the nonpayment of these taxes, but we do not know that to be true."

relied on a "general rule" as stated in 1 *Clark on Receivers* (2nd ed. 1929), p. 1008 (misprinted as p. 108). On the next page Clark states:

> "When a receiver is about to be discharged and the property redelivered to the owner, the receiver on the one hand is entitled to protection from liability, and on the other hand, just claims are entitled to be paid. In such cases provision is generally made for operation liabilities during the receivership and judgments rendered or to be rendered in favor of the interveners."

Such provision was here made by the revesting order and the Assumption Agreement.

ANSWER TO DEFENDANT'S CONTENTION ABOUT CONTINGENT CLAIMS.

We have shown that plaintiff's claims arose after the revesting (pp. 26-29, supra). Defendant argues that prior to the revesting the claim relative to the 1943 taxes was contingent and contends that contingent claims must be filed.

Claims not provable in bankruptcy are not discharged. Chapter X (former Sec. 77B) broadened the law with respect to what could be proved, but the matter is one of express statutory provision, and inspection of Chapter X shows that its reference to "executory or contingent claims" relates to claims arising out of contracts of the debtor which were in existence at or before the time the bankruptcy commenced or out of acts of the debtor occurring at or before that time. It does not relate to claims arising from the trustees' acts and unconnected with pre-existing contracts of the debtor. It does not relate to claims which may arise by reason of an enrichment, thereafter occurring, of the party to whom the assets have been returned, merely because the enrichment may in some way have its roots in acts of the trustees.*

---

*Thus, *City Bank Farmers Trust v. Irving*, 299 U.S. 433, and *Hippodrome Building Co. v. Irving Trust Co.*, 91 F.2d 753, cited by defendant, involved claims by a landlord for injury due to rejection of a lease of the debtor and involved specific provisions of Section 77B treating of leases and dealing with a specific problem which had aroused Congressional atten-

What plaintiff had, prior to the tax settlement of 1947, was not a contingent claim but merely a right to seek declaratory relief with respect to what would be the rights of the parties in the event that tax savings should arise in the future. *Maguire v. Hibernia Savings & Loan Society,* 23 Cal.2d 719 at 734.

A suit for declaratory relief against a Section 77 trustee may be maintained outside the Bankruptcy Court. *Gutensohn v. Kansas City Southern Railway Co.,* 140 F.2d 950 (8 Cir.). *A fortiori,* if a cause of action for coercive relief subsequently arises, a party cannot be held to be barred from presenting it to a federal court in equity merely because he had not presented a request for declaratory relief to the bankruptcy court at a time when he yet had no claim for coercive relief.

E. Reply to Defendant's Argument That There Can Be No Obligation to Plaintiff Because the Trustees Had No Authority to Incur It.

Defendant contends that the obligation here involved accrued before the reorganization was terminated. Defendant then seeks to avoid the fact of its assumption of the trustees' obligation by arguing that the obligation was not that of the trustees because they were not authorized by the court to incur it! (D. Br. 72.) Although plaintiff has been wronged and the defendant enriched, the wrong is to go unremedied and no one is to be held liable!

Defendant's citations refer, at best, only to the enforcement of express contracts.* Whoever voluntarily chooses to enter into a

---

tion. *American Service Co. v. Henderson,* 120 F.2d 525, and *Foust v. Munson SS Lines,* 299 U.S. 77, pertain to tort claims arising before institution of bankruptcy from personal injuries or from wilful acts of the debtor, not of the trustees. *Guaranty Trust Company v. Henwood,* 86 F.2d 347, involved rights under a pre-existing contract.

*They do not even go that far. In the principal citation, *Chicago Deposit Vault Company v. McNulta,* 153 U.S. 554, the question was as to the binding effect of an unauthorized long term lease for the portion of the term extending beyond the receivership. The court commented (p. 563) that the lessor had been fully paid under the lease for the time "that its premises were occupied for the benefit of the trust" and recognized the right in equity of a party supplying something of value to the receiver to be compensated although there had been neither previous approval nor subsequent

contract with court officers may be bound to ascertain the scope of their authority, on the principle pertaining generally to agents.

But the principle does not apply to non-contractual obligations. No one would think of asserting that, where a receiver is authorized to operate a railroad, the receivership is not liable for personal injuries resulting from negligence, because the court did not authorize the receiver to commit the tort. It is equally absurd to say that a receiver may unilaterally take another's money, property, rights or other thing of value to the enrichment of the estate and yet not subject the enriched estate to liability unless the court had authorized the receiver to incure the liability.

Court officers are held peculiarly bound by obligations arising on principles of quasi-contract and unjust enrichment (O. B. 91). In *Re Hunter,* 151 Fed. 904, an estate in bankruptcy was held liable when the trustee held over to the estate's benefit, after termination of a lease. In *Thompson v. Texas Mexican R. Co.,* 328 U.S. 134, a contract for the use of tracks was cancelled, but Section 77 trustees thereafter operated over the tracks. It was held that suit could be maintained against them by the owner of the tracks for the reasonable value.*

If a trust estate is enriched by the unauthorized acts of the trustee, the estate must account whether the act is an unauthorized contract or a tort *(Restatement of Trusts,* Sec. 269; 2 *Scott on Trusts,* Sec. 269 to 269.2). If a trustee, not empowered to borrow money for the trust, nevertheless does so to pay taxes on trust property and so applies the funds, the estate is liable in equity to the lender (*Restatement,* Sec. 269, Comment a, Illustration 1).

---

ratification. *Northern Finance Corporation v. Byrnes,* 5 F.2d 11, and *Byrnes v. Missouri National Bank,* 7 F.2d 978, also cited by defendant, were not cases of railroad receiverships and recognize a distinction between such non-railroad cases and railroad receiverships, the receiver in the latter having broader authority.

*Whether the old contract was properly cancelled and the terms on which trackage rights may be acquired were administrative questions for the Interstate Commerce Commission, and the suit was stayed for those issues to be decided, but the court was quite clear as to the consequences otherwise.

A leading case is Judge Cardozo's decision in *Whiting v. Hudson Trust Co.,* 138 N.E. 33; 234 N.Y. 394.*

Similarly, as is stated in 2 *Scott on Trusts,* Section 269.3,

> "It seems clear that a person conferring a benefit upon the estate should be permitted to recover against the estate even though the benefit was not conferred as the result of a contract with the trustee or as the result of a tort committed by the trustee. The principle here involved is the ordinary principle applicable to quasi-contractual obligations. If a person confers a benefit upon the trust estate under such circumstances that if the estate were owned by the trustee beneficially he would be entitled to recover in a quasi-contractual action against the trustee personally, he should be entitled to recover out of the trust estate."†

In *Central Trust Co. of New York v. Ohio Central R. Co.,* 23 Fed. 306, where a pooling contract was entered into between two railroads and the profits therefrom were collected and held by the receiver of one, he was required to account to the other, without regard to the validity of the agreement.

Moreover, defendant overstates the rule even in contract cases. While an unauthorized contract may not bind the receivership, it will create a personal liability of the receiver, which courts strictly enforce. *Haines v. Buckeye Wheel Co.,* 224 Fed. 289, 297 (6 Cir.); *In re Erie Lumber Co.,* 150 Fed. 817; 1 *Clark on Receivers,* (2d ed.) p. 527. As said in the Erie case, "It is ever the duty of the court to prevent, if it can, and, if not preventable, to redress so far as the laws permit, injuries inflicted upon others by its officers."

Here it is of no moment whether the liability was that of the trust or of the trustees personally, because by the Assumption

---

*There are numerous others. Cf. *Alphonzo E. Bell Corp. v. Bell View Oil Syndicate,* 46 C.A.2d 684; 116 P.2d 786.

†Analogously, as stated in 7 *Fletcher's Cyclopedia of Corporations* (Perm. Ed.) 721, Sec. 3579:

> "A corporation cannot receive money or property equitably belonging to another and not account for it, even though it was received in connection with an ultra vires contract or act of the corpotion. A court of equity * * * will compel an accounting. * * *"

Agreement defendant assumed all liabilities and obligations of the trustees in order that they might personally be exonerated.

Finally, the fact is that the trustees were authorized to do the acts from which the obligation to the plaintiff arose. The court had authorized the trustees to manage and conduct the business of the railroad (1098 D 20). This carried with it authority under *Internal Revenue Code,* Sec. 52 to file income tax returns in defendant's name (O. B. 43). Before filing the 1943 return the trustees had petitioned the court for authority to create the reserve fund (1772 P 58), and on the hearing the trustees' counsel explained the trustees' intention to file consolidated returns and to use the plaintiff's stock loss therein, and defendant's president testified to the facts (2023 D 34). The court then granted the petition (O. B. 27). The trustees were thereby authorized to do what they did and incur the legal and equitable consequences.

F. The Fact That Defendant Was in a Fiduciary Relation to Plaintiff Suffices to Prevent Destruction of Plaintiff's Claims.

Plaintiff's tax affairs were being managed by the agents of defendants and the trustees. None of plaintiff's officers or directors knew of the use of its stock loss except such as were also acting for the trustees. Plaintiff's director, Mr. Schumacher, knew the facts, but he was himself one of the trustees (O. B. 12), and plaintiff cannot be barred by his failure to present a claim against himself. Plaintiff's tax counsel were the very counsel who were acting for the trustees (O. B. 15). Its general counsel was also counsel for them (P. 2A, chart attached to Opening Brief). Even had he had any inkling of what had happened, he would never have been permitted to present a claim against them.*

---

*As said by the court below on this very subject (1053, 1054):

"The Court: Well, that would have been an adverse interest, wouldn't it? * * *

"I would never let a lawyer appointed in my court in a bankruptcy matter pursue that sort of thing. It is true that the trustees are officers of the court, but they are charged with preserving the res for the benefit of all parties involved, and if somebody asserts some claims that would involve, or have its impact, upon that res, certainly the man that asserts the claim couldn't be represented by the same man who represents the trustee as an officer of the court."

See also 1057.

By its acts defendant became a fiduciary to the plaintiff in the premises. It may not now take advantage of its own delinquency toward the plaintiff to retain what does not equitably belong to it.

There is no "sacro-sanctity to bar orders fixing a time limit within which claims against a receiver must be filed," and even in a case where such an order is proper and has been entered, it will succumb to opposing equities. *Wheeling Valley Coal Corporation v. Brady,* 159 F.2d 155 at 159 (4 Cir.). As was there said: "even where an order of this sort is made, it does not follow that its binding effect is greater than needs dictate." (p. 157, quoting *Glenn on Liquidation,* p. 429.)

CONCLUSION

The court below found that the "tax savings" arising through the use of plaintiff's loss was $17,201,739. We have shown that defendant's use of plaintiff's loss to discharge defendant's tax liability resulted in the unjust enrichment of defendant in that amount and that such enrichment should be paid over to plaintiff.

Defendant has in its possession large reserves held to pay any judgment rendered in this suit—reserves made up out of the very moneys which would have been paid to the United States, had not its taxes been paid by defendant's use of plaintiff's rights (O. B. 27). These reserves should reach their proper destination.*

---

*In a footnote (D.Br. 82) defendant briefly contends that plaintiff's claim relating to the 1943 taxes is barred by the statute of limitations. No such contention is made relative to 1944 or the claim for refund.

The claim for 1943 taxes is not barred. As noted at pages 26-29, supra, the cause of action did not accrue until 1947. This suit, when filed in 1946, was for declaratory relief, preceding the accrual of the cause of action. *Maguire v. Hibernia Savings & Loan Society,* 23 Cal.2d 719, 734; 146 P.2d 673.

If, as defendant contends, the claim arose while the trustees were in possession, defendant assumed it by the Assumption Agreement, the cause accrued as against it on the date of that agreement, December, 1944, and the applicable statute is Cal. Code of Civil Procedure, Section 337(1), prescribing 4 years for an action on a contract in writing. *Sherwood &*

Respectfully submitted,

HERMAN PHLEGER
MAURICE E. HARRISON
MOSES LASKY
BROBECK, PHLEGER & HARRISON
FRANK C. NICODEMUS, JR.
A. PERRY OSBORN
NORRIS DARRELL
MAHLON DICKERSON
LEROY R. GOODRICH

Attorneys for Plaintiffs and Appellants.

Dated: December 22, 1950.

Sherwood v. Gill & Lutz, 36 Cal. App. 707, 173 Pac. 171; *Anderson v. Calaveras Cent. Min. Co.,* 13 C.A.2d 338, 343, 57 P.2d 560.

Even apart from the written assumption, the period would be 4 years under C.C.P., Sec. 343, generally applied to suits in equity (*Sherman v. S.K.D. Oil Company,* 185 Cal. 534, 545, 197 Pac. 799), particularly for an accounting (*Moss v. Moss.* 20 Cal.2d 640, 644, 128 P.2d 526; *McArthur v. Blaisdell,* 159 Cal. 604, 115 Pac. 52; *Austin v. Harry E. Jones,* 30 C.A.2d 362, 368, 86 P.2d 379), which lies to settle the rights and liabilities between all persons standing in fiduciary relations to each other (1 *Pomeroy, Equity Jurisprudence* (5th ed.) Sec. 186(a), pp. 267-8).